STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

IN THE MATTER OF THE PETITION OF THE CITY OF PEKIN, A MUNICIPAL CORPORATION, FOR APPROVAL PURSUANT TO 735 ILCS 5/7-102 TO CONDEMN A CERTAIN PORTION OF THE WATERWORKS SYSTEM OF ILLINOIS AMERICAN WATER COMPANY	))))))	Docket 02-0352

REPLY BRIEF OF PETITIONER CITY OF PEKIN

Burt L. Dancey
William P. Streeter
Elliff, Keyser, Oberle & Dancey, P.C.
109 S. Fourth Street
Pekin, IL 61555
Phone: (309) 346-4148
Facsimile: (309) 346-0633

Benita A. Kahn
Daniel J. Buckley
Jason J. Kelroy
Vorys, Sater, Seymour and Pease LLP
52 East Gay Street
Columbus, OH 43215
Phone: (614) 464-6400
Facsimile: (614) 464-6350

Edward D. McNamara, Jr.
McNamara & Evans
931 South 4th Street
P.O. Box 5039
Springfield, IL 62705
Phone: (217) 528-8476
Facsimile: (217) 528-8480

Attorneys for Petitioner City of Pekin

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I. INTRODUCTION – RESPONSE TO IAWC'S SUMMARY:

Illinois-American's position, as set forth initially in their Summary and as exposed in their argument throughout, is replete with unabated overstatement, uncontrolled exaggeration, and self-serving myopia.

For instance, they take a value for the system – Leta Hals' $14,000,000 value – which they must know is squarely in the range that they, or any other interested company in this market place would use if valuing the Pekin system for sale or purchase; and unbelievably, almost magically, in Pekin's hands that marketplace income approach value, using many of Illinois-American's own figures and assumptions, becomes "seriously flawed." Moreover, Pekin's expert consultant, who meticulously set forth her basis, her approach, and the reasoning in this record, uses the very income approach applied by Illinois-American when it acquires water utilities. Yet she is accused of having no qualifications, being in flagrant disregard of standard appraisal principles, and knowing nothing. Instead, the absurd, completely overstated RCNLD value of $60,000,000 is substituted, shamelessly and vociferously, for reality.

Fire Chief John Janssen's straight-forward, honest, twenty-five plus year experience with fundamental safety problems in the system – low pressure, small mains and gravel – becomes entirely false. So it goes in the Illinois-American universe, unconnected to reality or the record. Everything they touch is worth $60,000,000, while Pekin is "entirely incorrect," has "no valid criticisms" and "provided inaccurate testimony."

In the world and in the record, according to Illinois-American, their evidence is "devastating", their experience and expertise is world quality, without parallel or without down sides; and Pekin really has no evidence, no experience, just a plea – "trust us." Illinois-American's consistent positions throughout – on whatever issue – are, given the evidence in the record, absurd.

Moreover, such an exaggerated approach, given this record and Pekin's evidence, the critical fundamentals of which were largely accepted by Commission's Staff witnesses, seriously undermines Illinois-American's own credibility by exposing the hype and the gross exaggeration in their witnesses, and in their evidence and in their argument.

As is demonstrated in the record, as was set forth in the initial brief of the Applicant City of Pekin, and as was confirmed by the substantive testimony of the Staff, Pekin has the needed resources, experience, citizen support and determination to acquire and manage the Pekin waterworks system. Dispositively, the record clearly shows that Pekin's ownership and operation will better serve the public interests for the future.

II. RESPONSES TO ARGUMENTS:

A. The City has the power to proceed with this condemnation.

At the end of its brief, Illinois-American ("IAWC") asserts, for the first time, that the City of Pekin (the "City") lacks the legal authority to proceed with the condemnation of the Pekin District system ("Pekin District" or "System"). See IAWC Brief, pp. 86-90. If

this argument had any substance behind it, it would have, and should have, been raised long before post-hearing briefing. This argument existed before the Illinois Commerce Commission (the "Commission") staff (the "Staff") and the City expended substantial time and effort preparing and reviewing hundreds of pages of pre-filed testimony and before the Commission conducted a week-long hearing. IAWC's assertion, besides untimely, is incorrect. The City has both the general power to acquire property outside of its boundaries and, by legislative grant, the eminent domain power to acquire the Pekin District in its entirety.

A municipality generally has the power to acquire property outside of its corporate limits. See, e.g., People ex rel. City of Salem v. McMackin, 53 Ill.2d 347, 365 (Ill. 1972). More specifically, Division 130 of the Municipal Code permits a municipality to purchase a waterworks system in its entirety. 65 ILCS 5/11-130-1 provides that "any municipality may purchase or construct waterworks or construct improvements to its waterworks as provided in this Division 130." 65 ILCS 5/11-130-1. Section 11-130-2 of Division 130 then defines the term "waterworks": "The term 'waterworks', as used in this Division 130, means and includes a waterworks system in its entirety or any integral part thereof, including mains, hydrants, meters, valves, stand pipes, storage tanks, pumping tanks, intakes, wells, impounding reservoirs, or purification plants." 65 ILCS 5/11-130-2. Therefore, Division 130 provides a municipality with broad powers to acquire an entire waterworks system, such as the Pekin District.

The legislature also granted municipalities the right of eminent domain to exercise Division 130's broad acquisition powers. "For the purpose of purchasing any

waterworks under this Division 130, or for the purpose of purchasing any property necessary therefor, the municipality has the right of eminent domain as provided by Article VII of the Code of Civil Procedure, as heretofore and hereafter amended." 65 ILCS 5/11-130-9. The City therefore has the power to use eminent domain to acquire an entire waterworks system (and any property necessary therefor), even if a part of that system may be outside of its corporate boundaries.

As recognized by the cases cited by IAWC, "A primary rule of statutory construction is that a court must give the language of the statute its plain and ordinary meaning." Village of Bolingbrook v. Citizens Utility Co., 267 Ill. App.3d 358, 359 (Ill. Ct. App. 1994) (citation omitted). Division 130 grants the authority to use eminent domain to acquire "a waterworks system in its entirety." See 65 ILCS 5/11-130-2; 5/11-130-9. IAWC's argument to the contrary ignores the plain and ordinary meaning of Division 130. IAWC's interpretation, however, would read the right of eminent domain completely out of Division 130, despite the legislature's specific grant in 65 ILCS 5/11-130-9, except in the rare instance where a municipality shares the identical footprint of a waterworks company.

In a desperate effort, IAWC argues Division 117. IAWC misses the point. Division 117 is inapposite. The City has proceeded under Division 130 from the outset. See Petition, Paragraph 3. Division 117 of the Municipal Code places no prohibitions on the ability of a municipal corporation to acquire and operate a waterworks system outside city limits. It does enable "any municipality [to] (1) acquire, construct, own and operate within the corporate limits of the municipality any public utility the product or

service of which, or a major portion thereof is or is to be supplied to the municipality or its inhabitants and may contract for, purchase and sell the product or service of any such utility . . ." 65 ILCS 5/11-117-1. Thus, Section 117 enables acquisition of the utility within the corporate limits of the municipality.

IAWC also cites Section 11-117-4 of Division 117 for support. See IAWC Brief, p. 89. A reading of this section, however, demonstrates that it contemplates condemnation outside the city limits. By omitting the bulk of this section, IAWC cites it in a very misleading way. The section provides:

> No municipality shall proceed to operate for hire any public utility for the use or benefit of private consumers or users, or charge for such consumption or use, unless the proposition to operate has first been submitted to the electors of the municipality as a separate proposition and approved by a majority of those voting thereon. The proposition shall be submitted in accordance with the provisions of Section 11-117-3. . . . Also any municipality, without such submission and approval, may sell water within and outside the corporate limits of the municipality from any water plant owned and operated by the municipality, and for this purpose shall have power to acquire by agreement, purchase or condemnation, rights of way not more than 35 miles beyond its corporate limits in the streets, alleys or other public ways of any city, village or incorporated town or unincorporated territory, even though such city, village or incorporated town or unincorporated territory to be served is not contiguous to the municipality, convenient and necessary for this purpose and to lay mains and construct and operate pumping stations, reservoirs and other necessary appurtenances therein. . . .

65 ILCS 5/11-117-4. This section is far different than anything found in Division 130. It generally requires a referendum for a municipality to operate for hire (as opposed to acquire) a public utility. It further permits the municipality to use the right of eminent

domain to acquire certain rights of way outside its corporate limits. The City does not rely on Division 117, but rather relies on Section 11-130-9, which authorizes a broader right that a municipality may condemn an entire waterworks system.

IAWC also discusses, at some length, the alleged inability of the City to use its home rule powers to condemn the waterworks, including the portions outside the city limits. See IAWC Brief, p. 87. While the City disputes this contention, the petition for condemnation before this Commission is not brought pursuant to the City's home rule powers. Instead, the City is utilizing the eminent domain powers of Division 130.

Finally, IAWC implies that the Commission's decision in Fernway Sanitary District v. Citizens Utility Company of Illinois, July 10, 1968 Order, Case No. 52024 (ICC 1968) somehow supports IAWC's contention that the City lacks the authority to condemn property outside of its boundaries. See IAWC Brief, pp. 11, 86. This implication is not supported by the Commission's actual Order in Fernway. First, Fernway, like Division 117 and the City's home rule powers, has nothing to do with the eminent domain powers granted in Division 130. Second, the Commission specifically recognized that the relevant statute in Fernway gave the petitioner the right to condemn property "either within or without its corporate limits" if consistent with the corporate purposes established upon creation of the Fernway District. See id., p. 5. The Commission's holding in Fernway was based entirely on the petitioner's self-limiting corporate charter, which restricted the petitioner to supplying services exclusively to the citizens located within its boundaries. See id. No such relevant restrictions exist here.

For all of the case citations in IAWC's Brief, the only authority that IAWC cites relating directly to Division 130 is Village of Bolingbrook, 267 Ill. App.3d 358. See IAWC Brief, p. 88. IAWC attempts to rely on this case as "construing Division 130 strictly against a municipality seeking to condemn a waterworks." Id. However, in Village of Bolingbrook, the issue being "strictly construed" was not whether extraterritorial property could be acquired by a municipality, but rather whether the municipality could proceed with an eminent domain action without first receiving Commission approval. In fact, the court specifically noted, "Since we find that the issue of ICC approval is determinative of the outcome of this case, we will confine our discussion to that issue alone." Village of Bolingbrook, 267 Ill. App.3d at 359.

IAWC's assertions that the City lacks the necessary authority to proceed with this condemnation are untimely, unsupported and against the plain and ordinary meaning of Division 130. IAWC's argument must therefore be rejected.

B. There is no record support for the concerns raised by IAWC regarding the extraterritorial customers within the Pekin District.

IAWC attempts, in its Initial Brief, to reconstitute the record and misconstrue Staff witness Johnson's testimony, so as to divert focus from his solid, factual conclusions.

As set forth in the record, and as clearly and concisely summarized in Staff's Brief, Staff witness Johnson conducted an independent and impartial public interest investigation. See Staff Brief, p. 5. He critically reviewed testimony and discovery materials by both the City and IAWC, and tried to objectively test the information, using his professional experience and judgment. See id. In his direct testimony, Johnson

found the public interest served regardless of whether the City or IAWC owned the Pekin District, and gave his opinion that the public interest might well be enhanced under City ownership. See id., citing Staff Ex. 1.00, p. 14.

Both in his direct testimony and in his answers on cross-examination, Staff witness Johnson agreed with the City and found that customers, both within the City and outside the City, gained certain advantages under City ownership. Included in those are advantages established by the City in the record: the income tax exemption, abilities to pursue funding sources unavailable to private enterprise, rate of return on capital, direct negotiations with developers and large industrial customers, integrated and flexible infrastructure planning, direct resolution of maintenance concerns, fire prioritization, citizen support, a proposed five year rate freeze, and the ability of most customers to maintain oversight of operations through accountability of elected officials. See Staff Brief, pp. 5-6; Staff Ex. 1.00, pp 16-17.

That long inventory of advantages to all customers of the Pekin District under City ownership and operation was reiterated by Mr. Johnson at the hearing during live testimony. See Hearing Testimony of William Johnson, pp. 72-73; 91-92.

In his rebuttal testimony, however, Staff witness Johnson became concerned about the City's inability to "guarantee" the non-discrimination commitments that the City had made to customers beyond City boundaries that were already part of the Pekin District. See Staff Ex. 3.00, p. 6. Staff witness Johnson's ultimate conclusion, largely unexplained, was that this "concern" about a lack of guarantee outweighed all the other advantages of the water system acquisition that were demonstrated in the record, and

accepted by him in his direct and rebuttal testimony. See id. He continued, in his rebuttal testimony, and in his testimony at the hearing, to endorse all other advantages of the Pekin District acquisition, as noted by the Staff in their brief. See Staff Brief, p. 6; Hearing Testimony of William Johnson, pp. 91-92.

It should again be noted that IAWC was unable to present any evidence that extraterritorial customers will be discriminated against if the City is permitted to acquire the Pekin District. It should be noted again, that through two separate resolutions, by two distinctly different City Councils, Pekin has said that extraterritorial customers will pay the same rates as Pekin citizens if it acquires the System. See Pekin Ex. 15.0, p. 11.

When questioned about his critical review of the testimony and discovery materials provided by both the City and IAWC, and when asked if he had any basis in the record to believe that the City would discriminate, improperly, against customers outside City boundaries, Staff witness Johnson said "No". See Hearing Testimony of William Johnson, pp. 75; 79-80. That needs to be reemphasized and noted, for it is critical. There is nothing in the record by way of factual foundation to suggest the City will improperly discriminate against extraterritorial customers. In fact, the evidence in the record shows the City's commitment to fair and equal treatment, as well as its history of treating extraterritorial customers fairly in the context of its wastewater billing for the residents of North Pekin. See Hearing Testimony of Dennis Kief, pp. 386-388. As noted as well in the Initial Brief of the City, there is no economic support or

justification for the baseless implication by IAWC that the City will discriminate against extraterritorial customers. See Pekin Brief, p. 37.

In its Initial Brief, IAWC incorrectly asserts that the City must demonstrate that acquisition will be "superior" from a public interest standpoint for extraterritorial residents. See IAWC Brief, p. 14; IAWC Draft Order, p. 5. Besides creatively inventing this heightened and wholly unsupported standard, IAWC goes on to characteristically, and perhaps understandingly, omit any mention, and foregoes any discussion of the manifold advantages set forth by Staff witness Johnson – advantages of City acquisition that would apply to all customers of the Pekin District, regardless of whether the customers live inside or outside of the City's limits. See, e.g., Hearing Testimony of William Johnson, pp. 72-73.

Instead IAWC focuses entirely on Staff witness Johnson's unsubstantiated concern, while adding misguided comments about the Brush Hill Fire Agreement and future annexation of new customers. IAWC's silence in response to the specific and substantiated advantages found by Staff witness Johnson is loud and clear.

In the face of uncontradicted evidence about fair and equal treatment of North Pekin customers in the wastewater system (see Hearing Testimony of Dennis Kief, p. 386, ln. 22 – p. 387, ln. 2; lns. 12-22; p. 388, lns. 1-7), in the face of uncontradicted evidence showing that it makes no economic sense to discriminate against a limited number of outside customers (see Pekin Ex. 17.0, p. 15, ln. 294 - p. 16, ln. 298); in the face of uncontradicted evidence as to the integrated nature of the Pekin community (see Pekin Am. Ex. 7.0, p. 1, ln. 13 – p. 3, ln. 54); and in the face of clear commitments by

two City Councils to fair and equal treatment (see Pekin Ex. 15.0, p. 11); IAWC only cites to a provision in the Brush Hill Fire Agreement, never utilized, which would allow flexibility to the Pekin Fire Department when fighting multiple fires. See IAWC Brief, p. 21; IAWC Draft Order, p. 8. Such strained concerns hold little or no weight against demonstrable factual evidence of benefit.

IAWC's speculation that the City would put annexation conditions upon water extensions for future developments is not sufficient to demonstrate improper motive and discrimination. The only evidence in the record indicates that all the annexations in recent history are voluntary ones, with developers wanting to come into the City for services. See Hearing Testimony of Richard Hierstein, p. 213, lns. 3-12; Pekin Ex. 1.0, p. 11, ln. 238 – p. 12, ln. 252. In fact, integrated and flexible infrastructure planning and direct negotiations with developers were a distinct advantage found by Staff witness Johnson with the City acquisition. See Staff Brief, pp. 5-6. Again, IAWC's position simply does not hold water.

IAWC's arguments ignore the record evidence in this proceeding that illustrates Pekin is a community that transcends municipal boundaries:

> Many of the persons living in the service area outside the Pekin city limits are business owners in Pekin. As business owners, they have significant influence in the city. Some examples of influential persons in Pekin who live outside the city limits include: the Executive Director of the Pekin Area Chamber of Commerce, as have traditionally, a large number of members of the Chamber Board of Directors, both school district superintendents, several top managers at Pekin Insurance, one member of the Water Study Task Force, and three members of the FLOW Committee, which promoted city ownership in the referendum. The Chamber of Commerce committee chairman who spearheaded the

> implementation of a city motor fuel tax to pay for the construction of Veterans Drive lives outside of the city limits. All of these people, and more, recognize clearly that they are part of a Pekin community. They promote the City and most of them are in favor of City ownership of the water system.

Pekin Am. Ex. 7.0, p. 2. ln. 38 – p. 3, ln. 49.

Fernway, relied upon by IAWC, is distinguishable. The Commission noted in Fernway that the petitioning district consisted of 226 acres and included 338 water customers. The extraterritorial area of concern in Fernway by comparison, contained 600 acres and 100 water customers. See Fernway, ICC Case No. 52024, at 2. As such, the percentage of affected extraterritorial customers in Fernway (22.8%) was almost triple the percentage of extraterritorial customers in Pekin (8.8%). When rejecting the petition, the Commission emphasized that the Village constituted more than 70% of the area involved and had the most potential for growth in population. Id. at 8. Neither of these facts exist in Pekin.

Moreover, Staff witness William Johnson's concern about the lack of guarantee of protection against discrimination for out of City customers, ignores protections under the common law available through judicial review. In the case of Inland Real Estate v. Village of Palatine, 107 Ill. App. 3d 279 (Ill. Ct. App. 1982), the Court was faced with a similar argument that review of rates by the Commission is required to protect the rights of certain consumers, where those consumers do not have a vote because they were not residents of a municipality. As the Court noted:

> We note, however, that the inability of the consumer to vote municipal officials in or out of office does not leave the consumer without a remedy, because the reasonableness of their rates is subject to judicial review. (*Conner v. City of*

Elmhurst (1963), 28 Ill2d 221, 190 N.E.2d 760; *Village of Niles v. City of Chicago* (1980), 82 Ill. App. 3d 60, 37 Ill. Dec. 142, 401 N.E.2d 1235; *Austin View Civic Association v. City of Palos Heights* (1980), 85 Ill. App.3d 89, 40 Ill. Dec. 164, 405 N.E.2d 1256) As the Supreme Court elaborated in Springfield:

"Municipal officers under the Municipal Ownership act cannot discriminate in rates or make exorbitant and unjust rates to consumers if they discharge their duties faithfully, honestly and efficiently under the act. All their rates and charges fixed by ordinances or resolutions are subject to review by the courts to a like extent as the rates fixed by the Public Utilities Commission for public utilities privately owned, although the matter of review may be had under a different law and by a different remedy." 292 Ill. 236, 253, 125 N.E. 739, 739, 746, *aff'd* (1921), 257 U.S. 66, 42 S. Ct. 24, 66 L.Ed. 131.

The Courts are in agreement that municipalities selling water to non-residents do so in their proprietary rather than their governmental capacity and, in so doing, are subject – as are privately owned utilities – to the rule that utility rates must not be unreasonable or discriminatory. (*Conner v. City of Elmhurst* (1963), 28 Ill.2d 221, 190 N.E.2d 760; *Amalgamated Trust and Saving Bank v. Village of Glenview* (1981), 98 Ill. App. 3d 254, 53 Ill. Dec. 426, 423 N.E.2d 1230; *Village of Niles v. City of Chicago* (1980), 82 Ill. App. 3d 60, 37 Ill. Dec. 142, 401 N.E.2d 1235.) As stated in *Austin View Civic Association v. City of Palos Heights* (1980), 85 Ill. App. 3d 89, 94-95, 40 Ill. Dec. 164, 170, 405 N.E.2d 1256, 1262:

"When a municipal corporation owns and operates a water system for the purpose of selling water to consumers, it is acting in a business capacity and is generally to be treated as if it were a private utility company. (Citations) * * * At common law, such as enterprise, because it had a monopoly on the service provided in the area, was prohibited from charging exorbitant rates and was required to serve all of its consumers without unreasonable discrimination in rates or manner of service. (Citations) Today, private utility companies are prevented from charging exorbitant rates or from engaging in unreasonable discrimination in rates or

> manner of service by statute, and are no longer subject to the common law. (Citation.) Though there is no statute that prevents municipal corporations that operate public utilities from acting in an unreasonably discriminatory manner, there is still the common law duty that prevents them from doing so."

107 Ill. App. 3d at 282-283.

The concern of Staff witness Johnson regarding the lack of guaranteed protection for the extraterritorial customers is met by those common law protections against discrimination. Moreover, that concern was entirely speculative, and not based on a factual foundation in the record. The record ran counter to the concern, in fact, for Johnson admitted there was nothing that indicated Pekin would improperly discriminate and not meet its approved resolutions for fair and equal treatment. The evidence in the record, accepted and acknowledged by Staff, is that there are numerous, clear, identifiable advantages of City ownership to all present customers in the system, extraterritorial customers included. In sum, the City has said twice by resolution that it will not discriminate, there is no evidence that it ever has, and even if it did, there exists a legal remedy.

C. IAWC's criticism of the financial feasibility and supporting analysis presented by the City does not withstand scrutiny.

1. Ms. Hals and RFC are qualified professionals.

IAWC first attempts to discredit the qualifications of Ms. Hals. See IAWC Brief, pp. 56-57; IAWC Draft Order, p. 21. The experience and expertise of Ms. Hals and RFC cannot be discredited, however. Ms. Hals has a Masters of Business Administration in Finance and, as demonstrated by her curriculum vitae, experience in a

broad variety of financial valuation, economic impact and feasibility projects involving public utilities and, more specifically, water utilities. See Pekin Ex. 5.1, Ms. Hals' Curriculum Vitae.

Ms. Hals also had the benefit of the resources and expertise of RFC, a highly experienced and reputable management and financial consulting firm. See Pekin Ex. 5.0, p. 2, lns. 14-17. RFC has conducted at least 18 water utility valuations for communities throughout the United States, including several analyses that involved subsidiaries of the American Water Works Company ("AWWC"). See id., p. 2, ln. 17 – p. 3, ln. 14; p. 4, lns. 12-30. "As a part of the valuation analysis, the majority of these engagements included financial feasibility analyses to estimate customer rate impact and long-term economic impacts associated with communities purchasing the water system that serves its constituents." Id., p. 3, lns. 10-12. In addition, "RFC has performed approximately 300 related financial, economic, and pricing studies, which have elements that are similar to valuation analysis concepts." Id., p. 3, lns. 13-14.

IAWC attempts to attack Ms. Hals' credibility by implying that her valuation analysis fails to conform with the [American Society of Appraisers] ASA Appraisal Standards. See IAWC Brief, p. 56; IAWC Draft Order, p. 21. However, IAWC's valuation expert had the opportunity to challenge Ms. Hals relative to the ASA standards, but never cited any specific standard promulgated by ASA, or any other authoritative body, and show how Ms. Hals failed to meet that standard. Even with their biggest criticism, Ms. Hals' exclusion of RCNLD, they were unable to point to any source to prove that Ms. Hals' methodology in this regard was flawed. IAWC is

attempting now to do by implication what it could not do directly. It is undeniable that the credibility and qualifications of Ms. Hals and RFC were established throughout this proceeding, and were not directly challenged with supportable criticism.

2. The feasibility of the City's five-year rate freeze is well documented*.*

IAWC challenges the feasibility of the five-year rate freeze highlighted in the City's testimony and cited by Staff as a benefit of City acquisition (see Staff Brief, p. 5) by suggesting that the City would be forced to rely on City reserves. See IAWC Brief, pp. 71-74; IAWC Draft Order, pp. 28-29. However, the record evidence clearly indicates that this rate freeze can, and will, be accomplished while operating the System on a self-sustaining basis. See, e.g., Pekin Ex. 5.0, p. 13, lns. 28-29; Pekin Ex. 17.0, p. 21, lns. 415-418; p. 22, lns. 432-435. "RFC's feasibility analysis is and has always been clear on this issue. There are no grants or City reserves in [RFC's] analysis used for supporting rates or finances of the water system… RFC's feasibility analysis is self-supporting." Id., p. 21, lns. 415-418. Specifically addressing the unsupported concerns of IAWC witness Kane, Ms. Hals further testified:

> Much of Ms. Kane's analysis hinges on the use of and the ability of the General Fund to support the water system… RFC has worked extensively in municipal financing similar to that anticipated by the City. RFC's analysis demonstrates that the water system can be operated on a stand-alone basis and would not need to be supported by the General Fund.

IAWC Ex. 8.0, p. 21, lns. 527-531.

Likewise, IAWC's suggestion that the City's rate freeze would require the City to defer capital spending (see IAWC Brief, pp. 71-74; IAWC Draft Order, pp. 28-29) is without merit. As explained by Ms. Hals, "As demonstrated in RFC's original testimony and alternate analysis, the rate freeze discussed by the City will not be at the deferral of spending for maintenance and capital improvements, but because current rates would generate revenues over and above revenue requirements under City ownership." Pekin Ex. 8.0, p. 22, lns. 542-545. RFC's original analysis actually supports an $8.8 million increase over the first ten years, not a deferral, in capital spending over that proposed in the IAWC capital improvement plan.

IAWC also attempted to discredit the City's rate freeze feasibility testimony by making "certain basic adjustments to the rate model" submitted by Ms. Hals. IAWC Brief, pp. 53-54; IAWC Draft Order, p. 20. However, these attempted arguments ignore much of the record, including tax savings, funding sources and savings, operation and management savings, and Ms. Hals alternate analysis and sensitivity analysis.

IAWC admits income tax savings by publicly owned utilities that are not available to IAWC. Staff endorsed this income tax exemption as a significant benefit of City ownership. See Staff Brief, p. 5; Hearing Transcript of William Johnson, p. 72, lns. 19-22. These savings support the credibility of Ms. Hals' feasibility analysis.

IAWC's own witness recognized the City's access to funding sources unavailable to IAWC. See Hearing Testimony of Randy West, p. 983, lns. 1-6 (acknowledging a grant received by the City but not available to IAWC). Staff also recognized the variety of funding sources available to the City when identifying that variety of funding as one

benefit of City acquisition. See Staff Brief, p. 5; Hearing Testimony of William Johnson, p. 73, lns. 1-7. IAWC admitted in discovery responses that tax-exempt debt only makes up 16.1% of its overall capital structure. The City would have access to this type of funding for 100% of its capital needs. See Pekin Ex. 8.0, p. 24, lns. 610-612.

IAWC failed to address the savings available under City ownership as a result of the City not having a required return on investment. The common equity return of IAWC comprises more than 45% of IAWC's capital structure, and the rate of return on equity is more than 11%, which is significantly higher than IAWC's cost of debt. See Pekin Ex. 17.0, p. 24, lns. 491-493. The "absence of a rate of return on capital improvements" was also recognized by the Staff as a benefit of City ownership. See Staff Brief, p. 5.

There is no support for the proposition that operation and management costs will increase under City ownership. In fact, reductions in operating costs are more likely because the City would not have to support the large overhead costs of the American Water Works system or costs associated with regulation. See, e.g., Pekin Ex. 8.0, p. 19, lns. 466-468. In addition, the City Manager testified to the variety of sources from which the City can obtain the advantages of mass purchasing, "As a governmental entity, we are entitled to national and state contracts for nearly every commodity we use. These contracts offer very large discounts. Additionally, we would have available to us the buying power of our contract operator." See Pekin Am. Ex. 7.0, p. 7, lns. 142-145. As opposed to increased costs, Ms. Hals testified that an incentive for cost reduction would be created through the City's competitive bid process for a contract

operator that could result in a 10% reduction in operating costs. See Pekin Ex. 5.0, p. 15, lns. 3-5; Pekin Ex. 8.0, p. 19, lns. 477-482.

IAWC completely ignores the revisions Ms. Hals incorporated in RFC's alternate analysis in her rebuttal testimony and alternate schedules. This alternate analysis incorporating all adjustments suggested by IAWC, except Mr. Reilly's valuation and Mr. Ruckman's asserted increased O&M costs, demonstrates the City could offer a 14-year rate freeze. See id. p. 18, lns. 447-450; Pekin Ex. 8.2, Attachment C to Rebuttal Testimony of Leta Hals, Alternate Schedule A-4. This alternate analysis demonstrates the City's pledge of a five-year rate freeze is conservative by nine years.

RFC's sensitivity analysis demonstrates maintenance of the five-year rate freeze even with a significant increase in operation and management costs. And financial benefits still resolve to the ratepayers (i.e., a rate freeze for four years) even assuming IAWC's worst case scenario of a 25% increase in operation and management costs:

> RFC determined that under the alternate economic analysis demonstrated in Attachment C of [Ms. Hals'] rebuttal testimony, the City could experience a 12.3% increase in capital costs (Ruckman, original testimony lines 265-267) and a 22% increase in O&M costs, and still maintain a five year rate freeze. If the City were to experience a 25% increase in O&M costs as suggested by Mr. Ruckman (derived from Ruckman's original testimony lines 209-278), the City would need only a 3% rate increase in the fifth year to cover revenue requirements.

Pekin Ex. 17.0, p. 20, lns. 389-395.

Finally, as the City explained in its Brief, "IAWC's feasibility analysis was based entirely on the $60 million valuation calculated by Mr. Reilly… Like a house-of-cards, when Mr. Reilly's $60 million valuation is pulled out, all of IAWC's challenges to the

financial feasibility and public interest of City acquisition fall." Pekin Brief, p. 29. Mr. Ruckman's rate analysis, which IAWC relies upon in a failed attempt to discredit Ms. Hals' rate freeze feasibility testimony (IAWC Brief, pp. 53-55), demonstrates this interdependency. As summarized by Ms. Hals, "[s]ince the rate increases [presented by Mr. Ruckman] are tied to an inflated valuation amount, the resulting projected rate increases are also inflated." Pekin Ex. 8.0, p. 20, lns. 506-507. This same criticism applies to all of IAWC's discussions regarding projected rate increases. See, e.g., IAWC Brief, p. 83. There is simply no support behind IAWC's challenges to the rate freeze, and the Commission should heed Staff's recommendation and find the rate freeze to be one benefit of City acquisition. See Staff Brief, pp. 5-6.

3. IAWC's RCNLD analysis and income approach analysis were prepared to create the maximum compensation possible for IAWC in an attempt to discredit the feasibility of acquisition.

As proven by Ms. Hals' Alternate Schedules and sensitivity analysis, the only way Mr. Reilly, Ms. Kane and Mr. Ruckman can support their claims that acquisition is not feasible is to create a valuation that is geometrically above what a willing buyer would or could pay. As testified by both IAWC and the City, a fair market value determination is based on the price at which an asset would change hands between a hypothetical willing buyer and a hypothetical willing seller and both parties have reasonable knowledge of the relevant facts. IAWC Ex. 10, p. 8, lns. 164-167; Pekin Ex. 17.0, p. 6, lns. 68-79. IAWC's valuation presented by Mr. Reilly and Mr. Riethmiller, and at the heart of Mr. Ruckman's and Ms. Kane's assertions of unreasonable rate

increases, ignores that a willing buyer would not pay a price that would prevent that buyer from recouping its initial investment. See id.

Consistent with Mr. Reilly's advise that experts advocating the key deprivation appraisal (which includes eminent domain) "can provide the kind of informed advice and counsel that clients or employers need to receive the maximum compensation in a deprivation", he presented a valuation for the Pekin District that is more than four times above what a willing investor-owned utility or a publicly owned utility would be able to recoup. See Hearing Testimony of Robert Reilly, p. 909, lns. 2-12.

a. IAWC never relies on RCNLD when valuing a utility for purchase.

The ultimate shortcoming in the credibility of IAWC's RCNLD valuation is confirmed by IAWC's testimony. Several IAWC witnesses acknowledged that IAWC, itself, does not perform RCNLD analyses when valuing a utility for purchase when IAWC is a willing buyer negotiating with a willing seller in utility acquisitions. See Hearing Testimony of Frederick Ruckman, p. 975, lns. 6-13; Hearing Testimony of Terry Gloriod, p. 757, lns. 9-11; Hearing Testimony of Robert Reilly, p. 889, lns. 11-15. IAWC's discovery responses went even further, stating neither IAWC nor its parent company, AWWC, utilize the RCNLD appraisal methodology when determining the value of a water utility. See Pekin Ex. 8.0, p. 3, lns. 54-60. It is unrealistic to appraise a business with a methodology that a "willing buyer" does not use in the marketplace. IAWC does not use RCNLD, when considering investment opportunities, yet finds this approach appropriate in the context of maximizing its compensation.

b. IAWC's inconsistency in assumptions allows it to maximize its income valuation.

As for the income analysis presented by Mr. Reilly, the only way he was able to maximize the value was to hypothesize that the most likely buyer could set rates as high as it would like and yet enjoy the lowest possible expenditures. This is the real reason why "[i]t is no coincidence" that the $70 million value under Reilly's income analysis "correlates exceptionally well" with IAWC's RCNLD analysis. See IAWC Brief, p. 70. The assumption that a buyer can set rates as high as it wants completely ignores the environment of the utility industry itself. Neither private nor public utilities can take advantage of their monopolistic status. Private utilities are regulated by the Commission and can only set rates to cover their expenses and earn a fair rate of return on their investment. Public utilities are regulated by the people. See, e.g., Staff Ex. 1.00, p. 16, lns. 358-360. Ms. Hals testified that "[j]ust because a municipality is not regulated does not mean that it will set rates at whatever levels it desires." Pekin Ex. 17.0, p. 4, lns. 40-44. Mr. Reilly agreed, testifying that "most municipalities operate utilities on a break even basis." IAWC Ex. 10R, p. 15, ln. 384.

IAWC criticizes Ms. Hals for her alleged failure "to recognize that the most likely hypothetical willing buyer for the Pekin system is a governmental entity". (IAWC Brief, p. 67). This criticism, like many others, is misplaced. Had Ms. Hals performed her valuation from the City's perspective, as opposed to the most likely willing buyer's perspective, she would have utilized municipal revenues and municipal expenses. This would result in a much lower value for the Pekin District because municipal systems run on a cash needs basis and do not earn a profit like IAWC. Pekin Ex. 8.0, p. 10, ln. 240

– p. 11, ln. 251. Instead, she did what the law requires, performed her analysis from the perspective of the most likely willing, knowledgeable buyer and seller.

Mr. Reilly's analysis, however, ignores the need to use consistent data, which would require the comparison of investor-owned revenues with investor-owned expenses or municipal revenues with municipal expenses. His income-based valuation relies on a significant analytical error that compares investor-owned revenues to municipal expenses to generate the greatest amount of cash flow and, thus, a significantly higher value. As explained by Ms. Hals:

> In essence, Mr. Reilly takes the revenues of an investor-owned utility, less the lower costs of a municipal utility to generate the greatest amount of cash flow. By then applying the municipality's lower cost of capital as a discount rate, he is able to invent an over-inflated value by picking and choosing the most helpful financial data from two different types of ownership.

Pekin Ex. 8.0, p. 11, lns. 261-264.

The bias of Mr. Reilly's analysis is exposed by his admission that municipalities operate their utilities on a break even basis. IAWC Ex. 10R, p. 15, ln. 384. If Mr. Reilly's objective is to represent a municipality as the most likely hypothetical buyer in his valuation analysis, then he should have used the most likely financial environment of the most likely buyer. By his own admission the most likely financial environment is the "break even" or "non-profit" nature of municipalities. His inconsistency confirms Mr. Reilly's bias in this case.

c. IAWC contradicts its own valuation expert when testifying it is not feasible for Pekin to purchase the system at $60 million.

The most telling argument against the credibility of IAWC's valuation is within IAWC's own contradictory testimony. IAWC states that it is not feasible to purchase the Pekin District at a value of $60 million, yet continues to insist that is what a willing buyer would pay. On the one hand, IAWC suggests (through Mr. Reilly's valuation) that a willing buyer would pay $60 million for the Pekin District. Yet, IAWC also argues (through Mr. Ruckman and Ms. Kane) that acquisition of the Pekin District for $60 million is not feasible because it would result in a 106% rate increase. If acquisition at $60 million is not feasible, it is not plausible to argue that a willing buyer would acquire the Pekin District at the IAWC valuation of $60 million.

4. The valuation supporting Ms. Hals' feasibility analysis demonstrates that acquisition is in the public interest.

a. Consistent with valuation methodology, Ms. Hals considered various valuation approaches and selected the income approach as the most appropriate.

IAWC incorrectly alleges that Ms. Hals' fair market valuation analysis must be rejected because it "relies exclusively on the income approach and disregards both the cost (RCNLD) and market approaches." IAWC Brief, p. 67; IAWC Draft Order, p. 27. This is simply not true. Even Staff rejects IAWC's contention:

> City witness Hals assesses the Pekin District value using several different valuation methodologies. She ultimately selects the income capitalization approach, which assumes that future earnings are the best measure of what a willing buyer and a willing seller consider in establishing fair market value.

Staff Brief, p. 7 (citations omitted).

The appropriateness of using an income approach analysis when valuing a regulated industry like a water utility is supported by the fact that the allowed rate of return is regulated, unlike other industries where the rate of return is unknown and somewhat dependent on the capabilities of the buyer. See Pekin Ex. 5.0, p. 17, ln. 29 – p. 18, ln. 1. As explained by Ms. Hals:

> The principal reason RFC used the income approach is because this approach is the most appropriate method for establishing value in this instance due to the regulated nature of the water utility industry. In a regulated environment, future profits should be the primary driver of a decision to purchase a water utility. Unlike an unregulated environment where the owner is free to price its product based upon market condition, Illinois-American is a monopoly, and its pricing is defined, and guaranteed, by the ICC.

Pekin Ex. 8.0, p. 8, lns. 181-186 (emphasis in original).

Ultimately, IAWC's protests regarding the appropriateness of the income approach lose all credibility by the acknowledgement of IAWC's President that IAWC itself has used this same valuation methodology to establish a value for utilities it has purchased in transactions where it is the willing buyer. See Hearing Testimony of Terry Gloriod, p. 757, ln. 12 – p. 758, ln. 10.

In addition to using the income approach, however, RFC's financial feasibility analysis also utilized the market approach as a reasonableness check in comparing the valuation amounts calculated by RFC and IAWC. See Pekin Ex. 8.0, p. 4, ln. 82 – p.6, ln. 117. As testified by Ms. Hals, "due to the subjective nature involved in comparing sales of water systems, in this case, a valuation analysis based upon the market approach should be used as a reasonableness check rather than the primary method

for establishing value." Id., p. 4, lns. 84-86. IAWC's President acknowledged that IAWC has also previously utilized a similar type of market reasonableness check. See Hearing Testimony of Terry Gloriod, p. 759, lns. 9-13.

Ms. Hals' market reasonableness check was created from recent water utility transactions in Indiana and Illinois. It used number of customers; date of utility transaction; net utility plant; revenues; EDITDA (Earnings before interest, taxes, depreciation, and amortization) and EBIT (Earnings before interest and taxes) as multiples for data points applied to the Pekin District's 2002 operating and balance sheet information. This demonstrated values for the Pekin District that "… are much closer to RFC's valuation than the value suggested by Mr. Reilly under the RCNLD approach." Pekin Ex. 8.0, p. 6, lns. 116-117.

IAWC's other challenges to Ms. Hals' market reasonableness analysis (see IAWC Brief, p. 65) attack comparability of the transactions selected by Ms. Hals. This argument loses all credibility by the fact that IAWC's own expert made no such comparisons. As recognized by Ms. Hals:

> Mr. Reilly also criticizes me for not comparing the properties that I discuss in my rebuttal in terms of condition, expected growth, source of supply, investment risk, etc. However, this testimony seems to be inconsistent with his analysis since I do not see discussion in his discovery that compares Pekin to his selected transactions on these points.

Pekin Ex. 17.0, p. 8, lns. 131-134. In addition, use of stock transactions are appropriate for a reasonableness check when the debt assumed by the purchaser is considered, as Ms. Hals did. See Pekin Ex. 8.0, p. 4, ln. 94.

Mr. Reilly particularly criticized RFC because they did not perform a Reconstruction Cost New Less Depreciation (RCNLD) valuation analysis. A valuation specialist must ultimately select which valuation approach, or combination of approaches, is the most appropriate for valuing a system, but it is not necessary to perform each approach before determining whether or not a particular approach is appropriate in a given situation. As Ms. Hals' succinctly responded to Mr. Reilly's assertions:

> Instead of "ignoring" the Reproduction Cost New Less Depreciation ("RCNLD") method as [IAWC] claims, I considered it and subsequently rejected it. The definition of fair market value requires the individual valuing the entity to consider it from both the willing buyer and willing seller perspective. To the extent a valuation method is not appropriate for either the willing buyer or the willing seller, then that valuation method can be excluded. A willing hypothetical private buyer would rarely, if ever, pay RCNLD for a regulated utility since it is highly unlikely it could include that full investment in rate base. Further, a municipality would never pay RCNLD because the resulting rate impact on customers would be significant. Therefore, whether the willing hypothetical buyer is either an investor-owned utility or a municipality, RCNLD would not be appropriate.

Pekin Ex. 17.0, p. 6, lns. 69-78.

The record evidence must also lead the Commission to question IAWC's assertions that "there is no uncertainty whatsoever in ascertaining the remaining life of the assets which comprise the Pekin Water System." IAWC Brief, p. 67. Substantial uncertainty does indeed exist in the RCNLD valuation presented by IAWC:

> Even [Mr. Reilly] admits in his testimony that engineers can reach different conclusions using the same methods (lines 272-274). Further, one must question the results of the RCNLD presented by Mr. Reilly when compared to the

> RCNLD analysis that was performed by Illinois-American in 1997 and updated in 1999 that estimated the value of RCNLD at between $34 million and $40 million (other values calculated in this study ranged between $17 million and $19 million) (Hals Surrebuttal Attachment 3). Although Illinois-American has tried to say that this was not an RCNLD analysis, Mr. Ruckman called it an RCNLD analysis, and it was labeled as an RCNLD analysis in the report itself. I would agree that the 1999 RCNLD analysis uses a different methodology than used to establish the value advocated by Mr. Reilly, but the 1999 RCNLD analysis points out the fact that it is not unreasonable that a different engineer may come up with a value much closer to $34 million, and thus a totally different RCNLD analysis than relied upon by Mr. Reilly.

Pekin Ex. 17.0, p. 10, ln. 178 – p. 11, ln. 189.

Unlike IAWC, Ms. Hals looked at the definition of fair market value and selected the appraisal standards that were appropriate for establishing fair market value, looking at the willing buyer and willing seller: "the fact is we considered all three approaches, as we are required to do, and have decided that some of the approaches will not produce a value that is appropriate in this case because it is not a value that would be paid by a willing buyer." Hearing Testimony of Leta Hals, p. 451, lns. 16-21. This approach is reliable, lawful and unassailable.

b. Ms Hals never assumed that original cost rate base equals fair market value.

IAWC also attempts to discredit Ms. Hals' analysis by asserting that Ms. Hals equated the value of the Pekin system with the made-up term "Original Cost Rate Base (OCRB)." See IAWC Brief, p. 57. Not surprisingly, IAWC was unable to provide a single citation for this statement.

The schedules presented with Ms. Hals' original testimony demonstrate that the calculation and value for rate base are completely different than the calculation and value for the Pekin system under Ms. Hals' income approach. In Ms. Hals' Schedule B-2, rate base is calculated directly from IAWC exhibits for Docket #00-0340 and is $11,529,436. See Pekin Ex. 5.2, Schedule B-2.

Ms. Hals' calculation to establish the value under the income approach, however, is much more complex. First, Ms. Hals forecasts operating, depreciation, and tax expenses (Schedule B-1); future rate base calculations (Schedule B-2); and future capital improvements and depreciation accumulations (Schedule B-3). See Pekin Ex. 5.2, Schedules B-1, B-2 and B-3. Ms. Hals then uses these factors to forecast the revenue requirements of a hypothetical investor-owned buyer and resulting rate increases and revenues (Schedule B-4). See Pekin Ex. 5.2, Schedules B-4. She then uses the ensuing net income, less capital investments, to determine the income available for distribution in the future (Schedule B-5). See Pekin Ex. 5.2, Schedules B-5. This distributable income is discounted to today's dollars to give a net present value for the Pekin District of $13,969,251. Not only is Ms. Hals' valuation estimate different from the rate-base calculation, it is actually 21% higher.

5. The Pekin District is not a "special use" property under Illinois law; IAWC's use of RCNLD is inappropriate.

a. The Pekin District has a readily ascertainable market value and is, therefore, not a "special use" property under Illinois law.

IAWC goes to great lengths to support its use of RCNLD by claiming the Pekin District is special use property. See IAWC Brief, pp. 60-67. It is not under Illinois law.

The definition of "special use" in Illinois is property that "has no readily ascertainable market value… which is something quite different from its unsuitability for other uses." Department of Transportation v. Mullen, 120 Ill. App.3d 268, 276 (Ill. Ct. App. 1983). There is no case in Illinois that designates a water system as a "special use." When examining the proposed condemnation of a privately owned water company by a local municipality, the Illinois Supreme Court stated, "'[t]his court and many others have often said that the measure of damages is the market value of the property condemned, and that in arriving at such value it is competent to prove any use, the highest and best use, for which it is adapted…'" Illinois Cities Water Company v. City of Mt. Vernon, 11 Ill.2d. 547, 551 (Ill. 1957), quoting, Metropolitan West Side Elevated Railroad Co. v. Seigel, 161 Ill. 638 (Ill. 1896). The Illinois Supreme Court never stated or intimated that the condemnee water company was a "special use" under Illinois law and should be valued by use of RCNLD. See id.

To the contrary, the Illinois Supreme Court has developed a long-standing and highly restricted special use doctrine that is applicable only in a "few exceptional cases in which market value cannot be the legal standard because the property is of such nature and applied to such special use that it cannot have a market value." City of Chicago v. Farwell, 286 Ill. 415, 420 (Ill. 1918) (citations omitted). Illinois courts interpreting this "special use" exception have held that the special use doctrine only applies when "the use of property may be so unique or special that it is not ordinarily bought or sold and that therefore no 'market' exists." Department of Public Works and

Buildings v. Huffeld, 68 Ill.App.2d 120, 128-129 (Ill. Ct. App. 1966), citing Farwell, 286 Ill. 415.

IAWC contends the Pekin District is a special use because of its "limited" marketability. See IAWC Brief, p. 60; IAWC Draft Order, p. 24. However, that is not the accepted "special use" standard in Illinois. As noted above, Illinois courts interpreting the special use doctrine have only applied it when "no market" exists. See, e.g., Huffeld, 68 Ill.App.2d at 128-129; see also Farwell, 286 Ill. at 420 (limiting the special use exception to properties that "cannot have a market value"). The existence of a demonstrated market for water utilities in Illinois was illustrated by the City in this proceeding. See Pekin Brief, pp. 32-33. There is a market for the Pekin District. Under Illinois law, the Pekin District is not a "special use" property and the use of an RCNLD analysis is inappropriate here.

IAWC falsely asserts that the City "did not submit any testimony whatsoever to rebut the testimony of Mr. Riethmiller in this proceeding" and implies that the City's election not to cross examine Mr. Riethmiller is meaningful. See IAWC Brief, p. 63; IAWC Draft Order, p. 25. IAWC's assertion and implication are wrong. IAWC's valuation expert, Ms. Hals, did contest the appropriateness of RCNLD throughout this proceeding. See, e.g., Pekin Ex. 8.0, pp. 6-8; Pekin Ex. 17.0, p. 6, lns. 69 – 78. As for cross examination of Mr. Riethmiller, no Illinois court has found a water system or even a comparable utility to be a "special use" as a matter of law. Because there is an ascertainable market for comparable water utilities, the Pekin District is not a "special

use" property, and RCNLD is inapplicable. There was no need to cross Mr. Riethmiller on the methodology used for his inapplicable analysis – the cases are clear.

b. RCNLD is not the required methodology for special use property in Illinois.

RCNLD is but one method of many that may be used to demonstrate value if a property is found to be special use. As the Illinois Supreme Court has held, "[t]here are a few types of improved property of which the market value cannot be ascertained because it is applied to a special use . . . [a]s to these types of property, which are in effect exceptions, the law permits a resort to any evidence available to prove value including the net income from a business conducted on the property." Chicago Land Clearance Commission v. Darrow, 12 Ill.2d 365, 372 (Ill. 1957); see also, Chicago City Bank & Trust Co. v. Ceres Terminals, Inc., 93 Ill. App. 3d 623, 630 (Ill. Ct. App.) (listing replacement cost as an example of an alternate valuation method for special use property).

IAWC's attempted reliance on generic treatises that do not address Illinois law and cases from other states provides no support for IAWC's position. Reliance on Massachusetts-American Water Company is inappropriate. In that case, the condemnor did not contest that the property in question was a special purpose property. See Massachusetts-American Water Co. v. Grafton Water District, 631 N.E.2d 59, 60 (Mass. Ct. App. 1994). The Moon Township case does not involve the acquisition of a water utility for continued use by a municipality, but the condemnation for highway construction at a site uniquely suited for a potential water treatment plant. See Moon

Township Municipal Authority Condemnation, 4 Pa. D. & C.3d 421, 421; 424 (Pa. Ct. Cmmn. Pls. 1978). The Moon Township court stated that use of replacement cost valuation is only appropriate "where there is no other way to determine just compensation," and evidence of replacement value "should not [be] received unless the circumstances were so peculiar as to render it absolutely essential, in the interest of justice, to require its admission." Id. at 424-425 (citations omitted); see also, Township of Manchester Department of Utilities v. Even Ray Co., Inc., 716 A.2d 1188, 1195 (N.J. Super. Ct. App. Div. 1998) (stating that when comparable sales method of valuation is unavailable, replacement cost is appropriate when condemnation necessitates the provision of substitute sewer facilities; however, "If no substitute facility is necessary, fair market value will be the standard for compensation, when it can be ascertained.") The cases from these other states cited by IAWC provide no controlling precedent relevant to this proceeding and, more important, do not stand for the proposition that only RCNLD can be used in the condemnation of the Pekin District.

IAWC misconstrues the holdings of the Illinois cases cited for the contention that replacement or reproduction is an allegedly preferred valuation methodology. See IAWC Brief, p. 61; IAWC Draft Order, p. 24. The court in Chicago City Bank & Trust merely cited replacement cost as an example of an alternative valuation method that may be available in cases of a "special use" property. See Chicago City Bank & Trust Co. v. Ceres Terminals, Inc., 93 Ill.App.3d 623, 630 (Ill. Ct. App. 1981). Also, the court in County of Cook allowed evidence of the cost of adjacent land to replace the school property that was taken because the school had a legal obligation to replace the

condemned portion. See County of Cook v. City of Chicago, 84 Ill.App.2d 301, 309 (Ill. Ct. App. 1967). In this proceeding, IAWC has no obligation to, and will not, replace the Pekin District if it is acquired by the City. Finally, in City of Chicago v. George F. Harding Collection, neither the classification of property as "special use" nor the appropriate valuation method was actually at issue. See 70 Ill.App.2d 254, 257 (Ill. Ct. App. 1965). Both parties in that case conceded that the subject property, a museum, was a special use that would be valued at replacement cost or reproduction value to accommodate the relocation of the museum. See id. IAWC did not establish that RCNLD must be used for special use property.

D. The City demonstrated that accelerated main replacement is necessary and can be accomplished with City acquisition.

Staff's Brief supports Staff witness Johnson's testimony that a capital improvement program tailored more toward main replacement and safety is one advantage of City acquisition. See Staff Brief, p. 5; Hearing Testimony of William Johnson, p. 91, ln. 16 – p. 92, ln. 13. IAWC contests this finding by arguing that "IAWC has addressed the issue of small diameter mains in the Pekin District System." IAWC Brief, p. 31; IAWC Draft Order, pp. 11-12. Despite IAWC's recognition that supplying fire protection is one of the primary purposes of the System (see IAWC Brief, p. 62), the public safety fire concerns raised by the System's small mains will not be fully addressed by IAWC for decades.

Properties have been lost as a result of the inadequate fire flow from these old water mains. See Pekin Brief, pp. 14-15; Pekin Am. Ex. 3.0, p. 4, lns. 86-87; p. 5, ln. 102. The City's Fire Chief testified the water mains pose a safety risk to persons in the

Pekin Community. See id., p. 5, lns. 107-110. While IAWC now challenges the identified risks posed by these small mains, even IAWC's Vice President of Engineering recognized that main replacement can provide better fire fighting flows. See Hearing Testimony of Mark Johnson, p. 946, ln. 18 – p. 947, ln. 2.

IAWC boasts that its recent main replacement "is triple the replacement rate of the last 20 years." IAWC Brief, p. 32; IAWC Draft Order, p. 12. This is unimpressive when one considers IAWC's previous sluggish replacement rate. IAWC acknowledges that it has taken 21 years to reduce the small mains by only 11% See IAWC Brief, p. 31; IAWC Draft Order, p. 11. With 89% of the problem mains remaining, at a replacement pace of 11% every 21 years, it would take exactly 169.9 years to complete the small main replacement. Only when IAWC's newly proposed 30-year replacement period is compared to IAWC's previous 170-year pace can IAWC's main replacement program be classified as "aggressive." See IAWC Brief, p. 32.

IAWC seems to suggest that having a multi-decade small main replacement program on paper somehow "addresses" the public safety concerns raised by these small mains. See IAWC Brief, pp. 31-32; IAWC Draft Order, pp.11-12. As emphasized throughout this proceeding, however, IAWC's "paper" plan can change. IAWC's main replacement program is subject to the ever-changing financial conditions for IAWC. See, e.g., Hearing Testimony of Mark Johnson, p. 956, lns. 12-16. Furthermore, despite IAWC's repeated emphasis throughout its Brief on the importance of Commission supervision, IAWC's capital improvement planning is not subject to Commission supervision. See id., p. 933, lns. 16-18; p. 934, lns. 1-19. As such, if a

decision is made by IAWC to alter, defer or cancel a planned capital improvement, such as the small main replacement program, neither the City nor the Commission will have input or review of that decision. See Pekin Brief, p. 16; Hearing Testimony of Mark Johnson, p. 934, ln. 1 – p. 935, ln. 9. This is especially concerning because, historically, "Illinois-American has been strong on planning, and very week in implementation." See Pekin Ex. 15.0, p 6, lns. 131-132.

Evidence in the record highlights the City's plans to "aggressively replace the inadequate mains, so that all areas of the City are served with acceptable pressures in the event of fire." Pekin Ex. 1.0, p. 13, lns. 292-293; see also, Hearing Testimony of John Janssen, p. 436, lns. 8-11. Despite IAWC's unfounded assertion that the City has not explained how it would approach the small main problem differently from the method IAWC has developed (see IAWC Brief, p. 32), the record fully supports the City's accelerated timetables for water main replacement. See Pekin Ex. 1.0, p. 13, lns. 288-293.

The City's ability to fund an accelerated main replacement program is concisely proven by a comparison of IAWC's actual capital improvement expenditures for the years 2003 through 2012 with Ms. Hals original analysis demonstrating feasible expenditures while maintaining the 5 year rate freeze. Ms. Hals did not have access to IAWC's actual capital improvement plan when she prepared her original feasibility analysis. As a result, the capital improvement numbers shown in original Schedule A-2 were an estimate of what she determined are necessary capital improvement expenditures for the Pekin District given RFC's extensive experience in the water

industry –- approximately $20 million for the 10 year period from 2003-2012. Ms. Hals' alternate Schedule A-2 incorporates IAWC's actual capital improvement plans for the years 2003-2012, totaling only $11.2 million. City acquisition results in maintaining the 5 year rate freeze while spending over $8.8 million more than projected by IAWC for its capital improvement expenditures.

Based on IAWC's numbers, the $8.8 million in additional capital improvement expenditures would have a dramatic impact on small main replacement. IAWC projected that it could replace 5,000 feet of mains annually at a cost of $300,000 per year (see IAWC Brief, p. 32). With the $8.8 million in additional capital expenditures, during the first ten years of City acquisition, the City could replace over 145,000 additional feet of mains, while maintaining all other capital improvements planned by IAWC. Unlike IAWC's "paper" plan, this main replacement can be made with only local interests and municipal and fire department priorities in mind. See Pekin Am Ex. 7.0, p. 11, lns. 225-227.

E. The citizens support acquisition by the City.

Staff recognized the citizen support demonstrated by recent referendum to be an advantage of City acquisition. See Staff Brief, p.5. IAWC, however, attempts to challenge the level of support for City acquisition voiced by the Pekin citizenry. See IAWC Brief, pp. 48-51. As part of its argument, IAWC points to a "vigorous campaign" waged by the City. See id., p. 49. The City, with the blessing of the State's Attorney, did spend limited funds on an informational campaign. See Pekin Am. Ex. 7.0, p. 12, ln.

266- p. 13, ln. 267. However, evidence presented in this proceeding illustrates that IAWC was the vigorous and more aggressive campaigner.

In the November 2000 referendum, in which the margin of defeat was only 54% to 46% [contrary to the 40% incorrectly noted in IAWC's Draft Order (p. 5)], IAWC spent $1,020,894 to sway the voters of Pekin with respect to that referendum. See Hearing Testimony of Terry Gloriod, p. 741, lns. 5-9. Then, in March of 2002, IAWC spent an additional $466,259 to fight City acquisition. See id., p. 740, ln. 16 – p. 741, ln. 4. Despite the expensive campaign waged by IAWC, this referendum found 61% of the City voters in favor of City acquisition. See Pekin Ex. 1.0, p. 8, lns. 165-170.

IAWC now challenges the reliability of the referendum results as a gauge of the views of the City residents because of allegedly confusing language. See IAWC Brief at 50; IAWC Draft Order, p. 18-19. Yet evidence presented in this proceeding suggests that "no one from the company complained at all about any confusion or misunderstanding prior to the results of the election, and overwhelming support for acquisition from the Pekin voters." Pekin Am. Ex. 7.0, p. 12, lns. 261-263. Now, however, in an attempt to support its allegations, IAWC cites to a survey response from a single voter in a survey sponsored by IAWC – a survey for which no background information regarding methodology, impartiality, response rate or total results was ever introduced. See IAWC Brief, p. 50; IAWC Ex. 5.0, pp. 14-15. Tellingly, however, even the lone "confused" voter quoted by IAWC indicates both he and his wife successfully recorded their desired votes. See id. There is simply no support for IAWC's challenges to the referendum's result. The Commission should thus adopt Staff's determination

that another advantage of City acquisition is the "citizen support demonstrated by recent referendum." Staff Brief, pp. 5-6.

F. City acquisition can be accomplished without having an impact on the water rates of IAWC's other rate areas.

IAWC suggests that City acquisition would harm all IAWC customers not a part of the Pekin District. See IAWC Brief, pp. 21-22; 84; IAWC Draft Order, p. 34. The sole basis behind this suggestion is Mr. Ruckman's speculation that the remaining customers of IAWC might face higher rates. See id. (citation omitted). As demonstrated in this proceeding, however, this suggestion is not supported by the facts. IAWC has a unified rate in Illinois, but has excluded the Pekin District from that unified rate because of the less expensive methods needed to supply water to the Pekin District customers. See, e.g., Pekin Ex. 1.1, Water Study Task Force Report, p. 3. As such, and as explained by Ms. Hals:

> Since the Pekin District has its own stand-alone rate, the only costs that would impact other customers of Illinois-American would be the common costs of the entire system. Since Pekin's operating revenues constitute only 3.40% based on it present rates (or 2.94% based on its proposed rates) as compared to the total Illinois-American operating revenues, the net impact on other customers should be immaterial.

Pekin Ex. 17.0, p. 20, ln. 404 – p. 21, ln. 408.

G. The Pekin District is not a complex system, and the City's plan to hire a reputable contract operator is well documented.

IAWC's President testified that "river water treatment is typically more complex" as compared to ground water supply. See Hearing Testimony of Gloriod, p. 750, lns. 13-14. Furthermore, during cross examination, IAWC's President was asked to

compare the Pekin District to several other systems in Illinois and testified that the Pekin District was "less complex" than all but one. See id., p. 750, ln. 6 – p. 751, ln. 19. The undisputed fact is the Pekin District is less complicated as compared to most systems because of the easy access to, and the high quality of, the water in the aquifer. See id. "The water is pumped from fairly shallow wells, and needs only minimal treatment before being delivered into the System for consumption." Pekin Ex. 1.0, p. 3, lns. 55-56. As such, the Commission should ignore IAWC challenges to the City's characterization of the Pekin District as not a "complex system." See IAWC Brief, p. 26; IAWC Draft Order, p. 10. The testimony of IAWC's own witnesses supported this characterization.

The Commission should also ignore IAWC's challenges to the City's assertion that it will hire a contract operator upon acquisition (see, e.g., IAWC Brief, pp. 5, 42, 85), as well as IAWC's assertion that IAWC is somehow "uniquely qualified to provide water service in the Pekin District." Id. at 7. There is no record support for either of IAWC's criticisms. City witnesses testified that, upon acquisition of the Pekin District, the City will hire a reputable contract operator to run the System. See, e.g., Pekin Am. Ex. 7.0, p. 5, lns. 87-89; Hearing Testimony of Dennis Kief, pp. 383-384. Staff also testified that if the City contracts with a professional certified contractor (whether it be United Water, U.S. Filter or IAWC), as is the City's plan, City ownership could serve the public interest just as well as IAWC's continued ownership. See Hearing Testimony of William Johnson, p. 77, lns. 1-8.

At this early stage of the condemnation proceedings, it is premature for the City to select the actual contract operator that will run the System. See, e.g., Pekin Ex. 17.0,

p. 19, lns. 367-371; Hearing Testimony of Dennis Kief, p. 383, ln. 14 – p. 384, ln. 2. Yet, testimony presented in this proceeding illustrates that the City can continue to enjoy all of the benefits, efficiencies and expertise of a seasoned water operator by hiring a reputable contract operator. See Pekin Ex. 17.0, p. 25, lns. 497-499. For example, both IAWC's President and Vice President of Engineering recognized that IAWC could be the contract operator for the System, and – if that were to happen – the full panoply of IAWC resources would still be available to Pekin District as a stand-alone system. See Hearing Testimony of Terry Gloriod, p. 722, lns. 5 – p. 723, ln. 10; p. 724, ln. 15 – p. 725, ln. 10; Hearing Testimony of Mark Johnson, p. 970, lns. 9-17.

H. IAWC's claims relating to the environmental conditions of the City's wastewater system are outside the scope of this proceeding and are unsupported by the record.

As noted in the City's Brief, the general purpose and duty of the Commission is to ensure that efficient and adequate utility service is provided to the general public at reasonable rates. See, e.g., Commonwealth Edison Co. v. Illinois Commerce Commission, 181 Ill. App. 3d 1002, 1007 (Ill. Ct. App. 1989) (citations omitted). As such, the environmental issues relating to the City's wastewater system raised by IAWC are not within the particular expertise of the Commission, and consideration of those environmental issues is beyond the Commission's authority. See, e.g., id. At 1008; 1011.

Even if these matters were properly before the Commission, however, IAWC's arguments are exaggerated. For example, IAWC places significant emphasis on the alleged sanitary sewer overflow ("SSO"). See IAWC Brief, pp. 23-24; IAWC Draft

Order, pp. 9-10. Contrary to IAWC's assertions, the City has made numerous efforts to work with the Illinois Environmental Protection Agency ("IEPA") to investigate whether the alleged SSO exists, despite the City's contention that no SSO is present. See Pekin Ex. 6.0, p. 5, lns. 101-105. For example, the City and IEPA conducted joint visual inspections of the manholes. See id., p. 5, ln. 105. The system was televised in the area of the suspected overflow. See id., p. 5, ln. 106. The City conducted dye water testing. See Hearing Testimony of Dennis Kief, p. 266, ln. 22- p. 267, ln. 1. Furthermore, Mr. Kief testified that additional plugging, cleaning and televising of the sewer system was scheduled to proceed after a delay that was beyond the City's control. See id., p. 278, lns. 2-10; Pekin Ex. 6.0, p. 5, lns. 107-113.

Also contrary to IAWC's assertions, there is evidence that the City has undertaken, and continues to undertake, steps to address and improve the environmental issues related to the wastewater system. The City performed significant expansions and extensions to the wastewater system, adding at least five miles of trunk lines to the system and upgrading all the lift stations. See Pekin Am Ex. 2.0, p. 10, lns. 207-210. The City purchased and installed generators at each lift station to assist in crisis management. See id., p. 10, lns. 210-211. In addition, over the last five to ten years, the City spent millions of dollars to eliminate sewer back-up problems identified by IEPA. See Hearing Testimony of Dennis Kief, p. 264, ln. 19 – p. 265, ln. 2. The City Manager also testified that "the City has invested substantial sums in capital improvements for the wastewater system, including lining [the City's] old brick sewers, upgrading every lift station in the system, constructing multiple extensions of lines to

accommodate new City growth, and primary upgrades in [the City's] televising and maintenance program." Pekin Ex. 1.0, p. 16, lns. 340-343.

As testified by Mr. Kief, the City's wastewater treatment facility has had "the usual amount of compliance issues over the years," but that is simply a fundamental part of operating a system, especially a wastewater treatment system. See Pekin Am. Ex. 2.0, p. 9, lns. 188-90; Hearing Testimony of Dennis Kief, p. 260, lns. 7-9 ("We comply with the terms of [the NPDES] permit, but again, like probably most, if not all, systems we have had some excursions from the permitting"). As Staff recognized, the deficiencies raised relating to the wastewater facility do not necessarily mean that the wastewater system is operated improperly, but instead that improvements are often necessary to meet IEPA regulations. See Staff Ex. 3.0, p. 4, lns. 70-73.

I. The City is best equipped to handle the projected "conditions in the water industry" cited by IAWC.

IAWC emphasizes the "future challenges" facing the water industry as support for IAWC's continued ownership of the Pekin District. See IAWC Brief, pp. 80-85; see also, IAWC Draft Order, pp. 32-34. Even a cursory review of the relevant portions of IAWC's Brief emphasizes that the concerns raised by IAWC are national in scope and raise nothing specific to the Pekin District. See id. IAWC's alarmist arguments lose all credibility given the limited capital improvement forecasts presented by IAWC in this proceeding. These limited capital improvement projections do not support the excessive infrastructure costs warned against by IAWC.

Even if the concerns in the report highlighted by IAWC turn out to be correct, the City will best be able to address these needs:

> The future capital needs of the Pekin system can be met more cost effectively with City ownership since a municipality enjoys a lower cost of capital. This lower cost of capital results from greater access to tax-free debt and the absence of the need to pay high premiums in equity to its shareholders.

Pekin Ex. 8.0, p. 23, lns. 568-571.

The Commission should be cautious of IAWC's implications that it has always voluntarily taken the necessary proactive actions to protect the health and well being of its customers. See, e.g., IAWC Brief, p. 25. For example, as testified to by Mr. Kief:

> In the beginning, with input from the City, the IEPA developed a Groundwater Needs Assessment for the Pekin area. I agree that the IEPA Groundwater Needs Assessment suggested that the City and water company work together to protect the ground water supply. However it was the City, not Illinois American, that submitted the technical information to the IEPA to establish the minimum and maximum setback areas around the wells. It was the City, not Illinois American, that incurred all costs in preparing the ground water protection ordinance… About the only thing that Illinois American has done as far as the Groundwater Protection Program is to offer a place for the meetings to be held and have a representative sit on the Pekin Education Committee.

See Pekin Ex. 6.0, p. 6, lns. 120-130; see also, Pekin Ex. 14.0, pp. 1-2.

The City has not only demonstrated its ability to financially address any future "conditions in the water industry," the City has continually received awards for its prior, and proactive water work. See Pekin Ex. 6.0, p. 6, ln. 131 – p. 7, ln. 137. The Commission should reject IAWC's assertion that "future challenges" facing the water industry support IAWC's continued ownership of the Pekin District.

III. CONCLUSION:

The people of Pekin came to the Commission to reclaim a precious natural resource and an important part of their future – their waterworks and the large, natural aquifer that lies beneath their homes and streets. They confirmed their goal with ballots, overwhelmingly. They established its feasibility by task force and expert reports. Now, before the Commission, they have demonstrated that City acquisition better serves the public interest.

The City's Water Study Task Force Committee, which was comprised of both City and extraterritorial water customers, recognized several benefits of City acquisition. As recognized by that citizen Task Force and further proven by the City in the record of this proceeding, City acquisition will: 1) significantly reduce future rate increases, 2) keep significant cash flow and profit dollars in the City, 3) allow the integrated planning of infrastructure (roads, sewer, water) maintenance, and 4) provide additional means to help manage future City growth. This list of proven public interest advantages of acquisition was further expanded by the City in the record of this proceeding to include, as recognized and supported by Staff: 5) prioritization of main replacements, 6) the City's income-tax exemption, 7) the City's ability to pursue funding sources unavailable to private enterprises, 8) the absence of a rate of return on capital improvements, 9) a proposed five-year rate freeze, 10) the City's ability to directly negotiate Pekin District concerns with developers and large industrial customers, 11) citizen support demonstrated by recent referendum, and 12) the ability of most customers to maintain oversight of Pekin District operations through the accountability of elected officials.

IAWC's assertion that there is no evidence to indicate the public interest would be better served by allowing the City to acquire the Pekin District ignores the record in this proceeding. The advantages listed above, and discussed herein, were proven by the City, recognized and endorsed by Staff, could not be refuted by IAWC, and illustrate that the public interest would be better served by giving the City the opportunity to follow the voters' desires and proceed with the acquisition of the Pekin District from IAWC.

For the reasons set forth more fully herein and the City's initial Post-Hearing Brief, the City respectfully requests the Commission to grant the City's Petition and issue an Order pursuant to the terms of 735 ILCS 5/7-102 granting approval to the City to commence eminent domain proceedings against IAWC.

Respectfully Submitted,

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//Edward D. McNamara, Jr.//

Burt L. Dancey
William P. Streeter
Elliff, Keyser, Oberle & Dancey, P.C.
109 S. Fourth Street
Pekin, IL 61555
Phone: (309) 346-4148
Facsimile: (309) 346-0633

Benita A. Kahn
Daniel J. Buckley
Jason J. Kelroy
Vorys, Sater, Seymour and Pease LLP
52 East Gay Street
Columbus, OH 43215
Phone: (614) 464-6400
Facsimile: (614) 464-6350

Edward D. McNamara, Jr.
McNamara & Evans
931 South 4th Street

P.O. Box 5039
Springfield, IL 62705
Phone: (217) 528-8476
Facsimile: (217) 528-8480

Attorneys for Petitioner City of Pekin

CERTIFICATE OF SERVICE

Edward D. McNamara, Jr., an attorney, hereby certifies that he served copies of the foregoing Post-Hearing Brief of Petitioner City of Pekin on the individuals shown on the attached Service List, via electronic mail, on Thursday, August 28, 2003.

//Edward D. McNamara, Jr.//
Edward D. McNamara, Jr.

SERVICE LIST

Donald Woods, ALJ
Administrative Law Judge
dwoods@icc.state.il.us

Andrew G. Huckman
Office of General Counsel
Illinois Commerce Commission
ahuckman@icc.state.il.us

Sue A. Schultz
General Counsel
Illinois-American Water Company
sschultz@illinoisamerican.com

Janis Von Qualen
Office of General Counsel
Illinois Commerce Commission
jvonqual@icc.state.il.us

Joe A. Conner
Attorney for IAWC
jconner@bdbc.com

Bill Johnson
Case Manager
Illinois Commerce Commission
Bjohnson@icc.state.il.us

Rochelle Phipps
Illinois Commerce Commission
rlangfel@icc.state.il.us

Boyd J. Springer
Attorney for IAWC
Jones, Day, Reavis & Pogue
bjspringer@jonesday.com